DOCUMENT RESUME

ED 147 647 CE 014 255

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TITLE A Government Policy To Induce Efficient Retraining During Unemployment.
PUB DATE Jun 77
NOTE 12p.
AVAILABLE FROM The Rand Corporation, Santa Monica, California 90406 (P-5904, $1.50)

EDRS PRICE MF-$0.83 Plus Postage. HC Not Available from EDRS.
DESCRIPTORS Administrative Problems; *Business Cycles; Employment Services; *Federal Government; Federal Programs; Females; Financial Support; *Government Role; Human Resources; Males; Manpower Utilization; *Policy Formation; Public Policy; *Unemployed; Unemployment; Unemployment Insurance; Vocational Education; *Vocational Retraining; Workmans Compensation
IDENTIFIERS United States

ABSTRACT

The government's role in retraining unemployed workers during nonrecession periods should be to subsidize retraining as they subsidize job search by way of the unemployment compensation system. The retraining subsidy should be about the same order of magnitude as the job search subsidy and should be administered by the public employment service which administers the subsidy to job search. The subsidy should support both institutional and on-the-job retraining, and it should be provided to both women and men. The percentage increase in retraining by women workers would likely exceed that of men workers if the policy proposed were adopted. An additional return from improving the allocation between search and retraining is the reduction of the unemployment rate as conventionally measured in the United States. (BL)

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A GOVERNMENT POLICY TO INDUCE EFFICIENT RETRAINING DURING UNEMPLOYMENT

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June 1977

U.S. DEPARTMENT OF HEALTH, EDUCATION & WELFARE
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ABSTRACT

This Paper focuses upon the government's role in retraining unemployed workers during nonrecession periods. To do so, a kind of deviation from the ideal competitive world of economics is considered. This deviation leads to economically inefficient retraining decisions and calls for a special kind of government policy to induce efficient retraining decisions. The deviation supports the suggestion that the government extend unemployment compensation to recently unemployed women and men who retrain rather than search to gain new employment. The amount of retraining by women relative to men workers would likely be greater if the policy proposed here were adopted. Improving the allocation between search and retraining has the added feature of reducing the unemployment rate as conventionally measured in the United States.

A GOVERNMENT POLICY TO INDUCE EFFICIENT RETRAINING DURING UNEMPLOYMENT

BY

Velma Montoya Thompson*

This Paper discusses the government's possible role in the retraining of unemployed workers during nonrecession periods. Should the U.S. government provide unemployment compensation for workers during retraining? To address this question, a kind of deviation from the ideal competitive world of economics is considered. This deviation leads to economically inefficient (that is, "Pareto non-optimal") retraining decisions and calls for a special kind of government policy to induce efficient retraining decisions. In this deviation, workers have systematically incorrect foresight about future job opportunities. Although the deviation is discussed in the economics literature and leads to the modern theory of unemployment, it has not been applied to an environment admitting the phenomenon of retraining. This paper extends the deviation to such an environment and reveals that there is a bias in the current U.S. unemployment compensation system toward job search activities but against retraining. This bias has created an overly large rate of unemployment in normal times, and can be corrected by extending our unemployment compensation system to support worker retraining as well as job search. The option of retraining generally is not available to individuals who are collecting unemployment compensation in the United States.

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*Staff Economist, The Rand Corporation. I wish to thank Tony Pascal for helpful comments on a previous draft of this paper.

I. RETRAINING AND THE FRICTIONALLY UNEMPLOYED

Paradoxical as it may seem, a positive level of labor unemployment is consistent with efficiency in a free-market economy. To clarify this point and relate it to the proper role of government requires a brief discussion of the nature of labor unemployment. (For more thorough discussions, see Alchian and Allen, 1972; Lucas, 1972.)

Suppose an employer experiences a decrease in demand for his product, so that he lowers what otherwise would have been his wage offers to his existing employees. Two distinct kinds of demand decreases could lead an employer to reduce his wage offers; one is an *inter-firm* shift in demand, and the other is a decrease in economy-wide, or aggregate, demand. *Frictional unemployment* is caused by shifts in inter-firm demands for labor. Although aggregate demand over all goods may remain steady, the demands for some goods fall while demands for others increase. For example, changes in consumer tastes often change the relative values of each type of labor in various uses. People whose services fall in value must either accept lower wages or shift to other jobs. When there is a relative shift in demand away from the goods of a certain firm, some of that firm's workers should accept the lower wage offer. Others should initiate a period of search for the best alternative job or retrain for another job rather than accept a lower wage. The workers in the firms enjoying higher demands should stay put. Those who decide to search

during these responses are said to be frictionally unemployed.

Aggregate-demand-deficiency unemployment occurs when there is a general decrease in demand for all goods. Workers *should not* search or retrain for new jobs because of a downward shift in aggregate demand, but many do so. These workers refuse to accept the lower wage offers in their existing jobs because they believe, erroneously, that other employers have not also reduced their wage offers below the normal trend level. That is, the workers erroneously believe that the aggregative shift is an inter-firm shift in demand. There would be no such inefficient unemployment if workers were correct about the general level of wages. When workers are correct in their assessments of the general wage level, the economy is termed a "full employment" economy. Of course, even in a full employment economy, there may be a positive, optimal level of labor unemployment. Relative demands for various products will continue to change with changing tastes, new products, etc. Such unemployment is all frictional.

In any economy prone to occasional unemployment due to deficiencies in aggregate demand, the normal level of frictional unemployment will be *too low* (Thompson, 1976). Suppose workers are initially correct about the general level of wages, but there is a shift in relative, or inter-firm, demands for labor. These are called "normal times." Some of the workers in firms that offer lower wages as a result of an inter-firm shift, believing erroneously that the lower offers may be the result of an aggregative shift and therefore that wage offers are lower elsewhere, will undertake too little search or

retraining. But none of the workers who are employed in the firms that are now offering higher wages will quit, even if they believe that the shift may be aggregative. The net result is a group of workers who search or retrain too little during normal times because of their inability to distinguish inter-firm shifts from aggregative shifts. (If workers *could* distinguish between these two types of shifts, aggregate-demand-deficiency unemployment would never occur.) The net value of resources devoted to search or retraining during normal times is therefore loo low. Those workers who should be induced by inter-firm shifts to move away from their current types of jobs erroneously believe that the reduction in their current wage offers may be the result of an economy-wide shift in demand.

During periods of recession, too many people are searching for jobs; during boom periods, too few are.[1] These inefficiencies, because of changes in aggregate demand, are fought, albeit imperfectly, with various governmental monetary and tax policies. But how does one fight the inefficiency associated with frictional unemployment? That is, what economic policy mitigates the free market's overly low rate of frictional unemployment?

Policies to combat this inefficiency would subsidize a worker who is faced with a reduced demand for his services from his current firm to search for his best alternative job or retrain. Such subsidies actually are provided in many modern economies in the forms of

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[1] During a boom, some of the workers who have suffered decreases in real demands in their current jobs as a result of simultaneous inter-firm shifts are unable to see this because of the increase in overall money wage offers due to the rise in aggregate demand and maintain their current employment rather than efficiently searching and retraining for new jobs.

government-provided unemployment compensation or government-provided retraining subsidies to unemployed workers (Seear, 1971; Wirtz, 1975.)[2] However, the latter form is generally not available in the United States. It is available only to those who can productively retrain while remaining eligible for normal unemployment compensation or be accepted in one of the few federally subsidized programs that provide a retraining subsidy. The vast majority of the latter are funded under the Comprehensive Employment and Training Act of 1973, which restricts these programs to low-income and disadvantaged people.

For an efficient rate of frictional unemployment during nonrecessionary times, U.S. government policymakers should subsidize job retraining just as they subsidize job search through the unemployment compensation system. There is no reason why a worker who has suffered a decline in the demand for his services by his existing employer should be subsidized to search for a new job but not to be retrained. The retraining subsidy should be about the same order of magnitude as the job search subsidy provided by the unemployment compensation system. It should support both institutional and on-the-job retraining, and it should be provided to both men and women. Of course, a policy

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[2] Thompson (1976) rationalizes the use of unemployment compensation to eliminate the inefficiency but does not discuss the parallel role of retraining.

[3] To the extent that workers differ according to who should retrain and who should search, the relative subsidies should differ. For example, suppose young workers are (1) less able to distinguish inter-firm shifts from aggregate demand shifts than older workers, and (2) more concentrated in occupations with a high level of inter-firm shifts relative to aggregate demand shifts than are older workers; then, the retraining subsidy should be larger than the search subsidy.

of retraining subsidies would require a mechanism for determining whether an unemployed person is serious about retraining and whether his or her educational plans make sense in the prevailing economic context; otherwise, some might use the system to take long vacations. For this reason, the public Employment Service should administer the retraining subsidy as it does the job search subsidy.

The effects of this retraining subsidy would be to (1) remove some part of the searching unemployed workers from the labor force as conventionally measured, and (2) add to the employed labor force those who would be attracted by the on-the-job training subsidies. Therefore, moving to this more efficient incentive system would lower the measured unemployment rate.

Finally, the percentage increase in retraining by women workers likely would exceed that of men workers with the option proposed here. For employed women report that their household responsibilities tend to inhibit their participation in after-working-hours retraining programs. One consequence is that employed women exhibit noteably lower rates of participation in company-subsidized educational programs in comparison to their employed male counterparts (Pascal, et. al., 1975). The result is a higher productivity of retraining for women than for men, other things equal, so that the option of retraining during periods of unemployment would induce an increase in the number of women relative to men retrainees in the labor force.

III. POLICY CONCLUSIONS

In periods of nonrecessionary activity, U. S. government policymakers should subsidize retraining as they subsidize job search by way of the unemployment compensation system. The retraining subsidy to a person who is faced with a reduced demand for his services from his current job should be about the same order of magnitude as the job-search subsidy provided by the unemployment compensation system. The subsidy should support both institutional and on-the-job retraining. And it should be provided to both women and men. The public Employment Service should administer the retraining subsidy as it does the subsidy to job search. The percentage increase in retraining by women workers would likely exceed that of men workers if the policy proposed here were adopted. An additional return from improving the allocation between search and retraining is the reduction of the unemployment rate as conventionally measured in the United States.

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